Ref: IOSL / BLR – FF / AERA – CP29

Dated: 09th Oct 2017

To,
The Secretary
Airports Economic Regulatory Authority of India
AERA Building, Administrative Complex
Safdarjung Airport, NEW DELHI – 110 003.

Subject: Consultation Paper No. 29/2017-18 dated 20th September 2017 to consider MYTP and Annual Tariff Proposal (FY 2016-17 to FY 2020-21) for the Second Control Period in respect of M/s IndianOil Skytanking Private Limited (IOSPL) for providing Fuel Farm Services at KIA airport, Bengaluru.

Dear Madam,

This has reference to the Stake Holders Consultation Meeting held at AERA Office on 04th October 2017 in regard to the subject.

We would like to thank the Honorable Authority for considering our tariff submission and the tariff escalation as mentioned in the Consultation Paper N. 29/2017-18 dated 20th September 2017.

However, we would like to draw your kind attention to our concerns, which are given below.

1. **Dead stock to be treated as depreciable Capital Asset:**

We are under Service Provider Right Holder (SPRH) agreements with BIAL and as per clause 22.2 of the same, on expiry or early termination of the agreement, IOSPL shall at its own cost & expenses and without any payment from BIAL, transfer the rights, title and interest in all Facility Capital assets, including dead stock to BIAL. The relevant clause is being reproduced below: -

22.2 Handing Over

Upon the expiry or early termination for any reason of this Agreement the SPRH shall at its own cost and expense (save as otherwise stated herein) and without any payment from BIAL:

In view of the above, IOSPL is bound to transfer such assets at zero cost to BIAL. It is essential to maintain the dead stock product at all the time in the pipelines & storage tanks for ensuring the operations and as such it becomes integral part of the pipelines & storage tanks. Such

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product available in the pipelines can-not be disposed / traded. In view of the above the dead stock of the product was treated as capital asset & depreciation was applied accordingly.

Authority's view of considering the dead stock product under non-depreciable assets, as it would have a residual value, vis-à-vis all other assets needs to be reconsidered. It may please be noted that at the end of the concession period, all assets including product dead stock shall be transferred to BIAL at zero cost. We have since commencement of operations considered this as depreciable asset on the above principle and would request the Authority to allow continuation of the same for the further period like all other capital assets.

Alternatively, we suggest that the Authority issues the specific order that the product dead-stock would be transferred to BIAL at the end of the Concession period at a value.

2. **Fair return on equity:**

The authority has considered Fair Return on Equity at 14% pa as against the calculated Fair Return on Equity of 17.15 % as per the AERA model taken by us while determining the tariff for the second control period

Cost of equity (**k_e**) has been computed using the Capital Asset Pricing Model (CAPM) in line with the recommendations of the AERA guidelines. CAPM uses various parameters in the model as described below.

1. **Risk Free Rate (R_f)**

Risk free rate adopted for this calculation is the yield on the 10-year Government of India Bond as on February 4, 2016. This was **7.838%** on that date.

2. **Market Rate of Return (R_m)**

The average market rate of return was computed taking into account the movement of the BSE Sensex for the last 20 years from 1996 to 2015. The value arrived at was **16.15 %**.

3. **Beta (β)**

Beta measures the systematic risk or volatility associated with the shares of a company. Beta of the market in case the BSE Sensex is 1.

In our calculation, Beta was taken as the average of the beta of the major oil companies as on February 4, 2016 who are in the business of oil marketing as per noted below.

- Hindustan Petroleum – 1.33
- Indian Oil Corporation – 0.78
- Bharat Petroleum – 1.25

The average Beta of the above works out to **1.12** and the same was considered by us.

Considering the above values

$$k_e = R_f + \beta x \text{ EMRP}$$
Where, EMRP = $R_m - R_f$
$$k_e = 7.838 + 1.12 \times (16.15 - 7.838) = 17.15\%$$

Hence Cost of Equity after applying the CAPM approach is **17.15%.**

We request the Authority to kindly consider 17.15% as Fair Return on equity.

3. Escalation in Manpower Cost (Part of operating cost):

The major cost element for the service provider for fuel farm operation is the manpower cost which is approximately 40 % of our total operating cost (excluding Airport operator fees). We are mainly employing Engineers for our Fuel Farm operations. These officers are being trained & necessary DGCA certifications awarded enabling them to carry out their jobs of handling the Aviation Fuel. The Authority has considered annual escalation of 8% in the manpower cost to give a conservative impact of inflation. We would like to submit that in IOSPL manpower cost are being escalated @ 12-15%. We had already taken a conservative increase of only 12%. The annual increase in manpower cost (salaries & wages) may thus be considered at 12% which will help us in the retention of trained manpower.

To substantiate the above argument, we give below the actual data on personal costs for the last three years: -

Year	Pay roll Cost Amount as per Annual Compliance	Increase / Decrease over last year	% increase over last year
2014-15	Rs 18,970,223.00		
2015-16	Rs 21,781,145.00	(+) Rs 2,810,922.00	14.81 %
2016-17	Rs 26,626,277.00	(+) Rs 4,845,132.00	22.24 %

We thus request the Authority to consider annual increment of 12 % in case of manpower cost in view of the above submissions.

4. Honoring the SPRH agreements executed with BIAL:

Fuel Farm operations was awarded to us on BOOT basis against the competitive bid by BIAL. Consequently, SPRH agreement was executed with BIAL on 01st March 2006. In accordance to part III of the agreement, IOSPL is entitled to recover the Facility payment for the capital investments. The capital expenditure are incurred only after approval from BIAL As per the agreement thus, IOSPL is entitled to recover the throughput charges comprising of Facility payment + Operating cost + operating fees + Air operator fees. The Throughput fees including the operating costs are annually approved by BIAL. Any amount over & above the Facility Charge if recovered is to be transferred to SPRH reserve fund. Funds from SPRH reserve funds are to be used for capex and can be withdrawn only on approval from BIAL.

The above mechanism is as elaborated in the SPRH agreement and we thus request the Authority to honor the agreements already in place, based on which the shareholders have invested. In this regard you are please requested to refer to our letter no IOSL/BLR FF / MYTP 2016-17 dated 08th July 2017(Copy attached for ready reference). Because of lower throughput charges, there are already under recoveries to the tune of Rs 17.71 crores for the year 2013-14 to 2016-17, which has been mentioned at point no 12 of the letter.

5. Determination of tariff (trued up):

As per Table 18 of the Consultation paper 29/2017-18, the FIC (which is nothing but Throughput fees) has been arrived at Rs 1808 / kl as against the tariff of Rs 1700 / kl as sought by us. We are also grateful to AERA for recognizing the under recoveries to the tune of Rs 31.96 Crs in the Second Control Period, in case tariff of Rs 1700 / kl is approved. The under recoveries would thus at the end of second control period mount to Rs 49.67 Crs as under

Narration	Amount in Crores
Under recoveries as per Table 18 of the consultation paper for the period 16-17 to 20-21	Rs 31.96 Crs (*)
Under recoveries on account of non-consideration of Facility payment recovery in line with the SPRH agreement for the period 2013-14 to March 2017 as already discussed in point no 1 above	Rs 17.71 Crs (*)
(*) Excluding interest cost	

The above under recoveries are mounting considering the delay in grant of approval by the Authority.

6. Terminology used in the CP:

Rs 1700 / kl is the Throughput charges and not FIC as mentioned in the consultation paper. We request the Authority to use the word "Throughput charges or Fees" instead of FIC in the final approval.

The Authority under the price cap mechanism as indicated under table no 18, have calculated the annual FIC (Throughput fees) at Rs 1808 / kl and ideally this rate needs to be approved by the Authority. However as guided by the Authority during the consultation process held on 04.10.2017, we are agreeable for the rate of Rs 1700 / kl as Throughput charges for fuel farm operations at Bangalore. However, at the time of of submission of annual compliance we shall resubmit our tariff proposal considering our under recoveries.

We would like to thank and request the Honorable Authority to expedite the approval of the tariff as proposed in the consultation proposal.

Thanking you,

Yours truly
For IndianOil Skytanking Private Limited

09/10/2017
T S Dupare
Chief Executive Officer

CC: - VP, Business Development, Marketing & Strategy – BIAL